U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Testimony of
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Before the
U.S. House of Representatives Committee on Small Business
March 25, 2009

Chairwoman Velazquez and other distinguished Members of this Committee, I appreciate the opportunity to submit this written statement in connection with the Committee's hearing on waste, fraud, and abuse in Government programs.

As a federal credit agency with an $88 billion loan portfolio, the principles of stewardship, transparency and accountability are essential to the integrity of the programs and operations of the U.S. Small Business Administration (SBA). With the recent passage of the American Recovery and Reinvestment Act (Recovery Act), as well as the FY 2009 Omnibus Appropriations Act, Federal agencies will be held accountable not only for developing effective and efficient strategies for implementing the new statutory provisions but also for the prudent stewardship of taxpayer dollars used for funding the programs authorized under these acts. The SBA takes its on-going responsibility to guard against and to prevent waste, fraud and abuse in its programs very seriously. Ensuring that proper controls are in place is crucial to the Agency's ability to implement and administer its programs in an environment that inhibits fraud, waste and abuse.

Maintaining Integrity and Accountability in our Programs

The SBA believes that maintaining the integrity and accountability in all programs and operations is critical for good government. We believe that our Agency demonstrates responsible stewardship over assets and resources by providing high-quality, responsible leadership; by effectively delivering services to customers; and by maximizing desired program outcomes. The Agency has developed and implemented management, administrative and financial system controls that reasonably ensure that: programs and operations achieve intended results efficiently and effectively; resources are used in accordance with the mission of the Agency; programs and resources are protected from waste, fraud, and mismanagement; program and operations activities are in compliance with laws and regulations; and reliable, complete, and timely data are maintained and used for decision-making at all levels.

American Recovery and Reinvestment Act of 2009

The Administration is committed to investing Recovery Act dollars with an unprecedented level of transparency and accountability so Americans know where their tax dollars are going and how they are being spent. The guidance issued by the Office of Management and Budget (OMB) on February 18, 2009 contains critical action steps that Federal agencies must take immediately to meet these objectives and to implement the Act effectively. The guidance addresses Federal agency requirements to provide spending and performance data to the "Recovery.gov" website. In addition, the guidance establishes requirements for various aspects of Recovery Act planning and implementation. These requirements are intended to meet the following crucial accountability objectives:

- Funds are awarded and distributed in a prompt, fair, and reasonable manner;
- The recipients and uses of all funds are transparent to the public, and the public benefits of these funds are reported clearly, accurately, and in a timely manner;
- Funds are used for authorized purposes and instances of fraud, waste, error, and abuse are mitigated;
- Projects funded under the Recovery Act avoid unnecessary delays and cost overruns; and
- Program goals are achieved, including specific program outcomes and improved results on broader economic indicators.

The SBA has initiated steps to comply with OMB's guidance by establishing a risk management team. This team will develop appropriate risk management plans that include risk assessment and risk mitigation strategies that are designed to effectively implement the various provisions of the act while at the same time providing the American taxpayer with the unprecedented level of transparency and accountability that the Administration is committed to. Periodic testing and validation of these plans will be key components of our strategy to monitor our performance and to reduce the potential for fraud, waste, or mismanagement.

FMFIA

The SBA's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers Financial Integrity Act of 1982 (FMFIA). FMFIA requires federal agencies to conduct an annual assessment of internal control and report the results to the President. The most recent assessment indicated that there were no material weaknesses in the design and operation of the Agency's internal controls. Nonetheless, SBA continues to strengthen the internal control over its programs and operations.

During FY 2008, the SBA conducted its third annual assessment of internal control over financial reporting to comply with the Office of Management and Budget's (OMB) revised Circular No. A-123 Appendix A, Internal Control Over Financial Reporting, which is similar to that imposed on publicly traded companies by the *Public Company Accounting Reform and Investor Protection Act of 2002 (the "Sarbanes-Oxley Act").* The Senior Assessment Team (SAT), chaired by the Chief Financial Officer (CFO) and composed of SBA managers from the major programs and support offices, directed this effort. The SAT reviewed the key business processes impacting financial operations and the financial statements and no material weaknesses were identified.

<u>Audits and Investigations</u>

All of us at SBA recognize the important oversight role provided by the Office of Inspector General (OIG) and the Government Accountability Office (GAO) in identifying waste, fraud and abuse in government programs. I want to assure you and members of the Committee that we are working diligently to implement recommendations contained in GAO reports and OIG audits that identified waste, fraud and abuse in SBA programs. Let me briefly provide you with a summary of important actions taken to date.

HUBZone

The GAO report entitled *Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results* that was issued in June of 2008 identified potential waste, fraud and abuse by identifying firms participating in the HUBZone program that may not have met the program's eligibility requirements. In response, the SBA has changed the criteria for selecting firms for program examinations to only those that received HUBZone contracts within a particular FY to target examination resources to firms mostly likely to be incorrectly receiving awards, changed the internal certification process, and is in the process of completing a business process reengineering (BPR) program to improve the program and decrease potential waste, fraud and abuse.

Over the last 8 months since the report was issued, SBA has developed new procedures for evaluating all applications, recertifications, and program examinations. As a result of these new procedures, SBA has conducted an average of 1.8 unannounced site visits per month.

SBA is collecting supporting documentation from all firms that seek HUBZone certification or wish to maintain their HUBZone status. While these procedures have impacted our processing times, we believe they are helping to reduce incorrectly certified firms. For example, from July 2008 to March 2009, only 22% of the applications submitted were certified while 77% were withdrawn or declined. During the same period a year ago (July 2007 to March 2008), 66% of the applications submitted were certified while 33% were withdrawn or declined.

SBA is also in the process of reviewing its current program regulations to determine whether changes can be made to further strengthen certification procedures to help mitigate fraud and abuse, as well as reducing accidental mistakes. In addition, if the HUBZone program office believes it has sufficient evidence that any firm willfully attempted to misrepresent its HUBZone status, the program office will forward those firms to SBA's Suspension and Debarment Official (SDO) and to the OIG.

Regarding specific timetables and procedures to ensure that the HUBZone maps remain current, the HUBZone program office completed a comprehensive scope of work and it is working with the acquisition office to complete a solicitation package to study and update current maps. The SBA's HUBZone maps were last updated on September 13, 2008. The SBA intends to update the maps again by April as a result of new data received from the U.S. Department of Housing and Urban Development and the Office of Management and Budget.

On July 17, 2008, SBA testified that it was beginning the process of reviewing possible suspension and debarment of the 10 firms originally identified by GAO in the report titled *SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*. GAO originally referred the 10 firms to SBA's OIG. In September 2008, SBA's OIG forwarded the files to the HUBZone program office so that it could begin its examination process. Investigation of these ten firms revealed that at least three of the firms that GAO initially believed to be ineligible for the program were in fact eligible HUBZone firms. Of the remaining seven firms, only three are still in the HUBZone program and are currently undergoing program examinations for possible decertification action. All firms noted by the GAO have been investigated and examined by the SBA or are currently being investigated and examined by the SBA. There are due process considerations for the firms being investigated and before any action can be taken the SBA must complete the program examinations already underway, propose the firms for decertification if appropriate, and allow them an opportunity to respond. 13 C.F.R. § 126.503.

The firms that have been referred to the SBA's Suspension and Debarment Official are also being investigated by that office, some in conjunction with the HUBZone program office. Firms being investigated for possible suspension and debarment must also be afforded due process by this office as well. Without a criminal indictment, conviction or a civil judgment, the SBA must also meet an evidentiary standard by providing the firm with due process before reaching a debarment/suspension decision. While the information provided to SBA by the GAO showed areas for concern, the information provided did not meet the usual evidentiary standard applied by SBA. Consequently, while rules allow for debarment without the need for either a civil or criminal proceeding, SBA determined that acting without a prior finding of cause required a more in-depth and thorough review by the SBA's Suspension and Debarment Official in order to meet the due process and evidentiary requirements established in regulations. The SBA's Suspension and Debarment Official has requested specific, detailed information from these business concerns to assist with a determination on how next to proceed

As soon as the HUBZone office receives the GAO's files of its most recent investigation, SBA will take appropriate enforcement actions on the firms we find to violate HUBZone program requirements. These enforcement actions will include, where applicable, removal or decertification from the program, and coordination with SBA's OIG and SBA's Suspension and Debarment Official.

Finally, the HUBZone program office embarked on a "Business Process Re-engineering" (BPR) to address the items delineated in the GAO audit report, as well as to tackle the findings from the GAO's Forensic Audit investigation. The BPR goal is to improve the operations and effectiveness of the program. This initiative involves the detailed examination of the current state of operations, articulation of recommendations to improve the program, and the development of a roadmap for improved operations within fiscal constraints. This roadmap will be completed this fiscal year.

8(a) Program

In response to the GAO report on our 8(a) Program released in November 2008, the Office of Business Development has taken several critical actions to increase oversight of 8(a) participants.

- The Office of Business Development issued guidance, in the form of an SBA Information Notice on November 18, 2008. This Notice reminded SBA staff that it is each District Office's responsibility, in conjunction with conducting an Annual Review, to identify whether any changes have been made by the 8(a) BD Program Participant to management agreements or other corporate documents that may affect the Participant's continued eligibility.

- The Office of Business Development conducted training sessions on July 15, 16 and 17th in Dallas, Texas for every Business Development Specialist that had an ANC firm in his or her portfolio. The Office of Business Development conducted comprehensive training regarding the specialized rules pertaining to firms owned and controlled by tribes, ANCs, and NHOs. SBA's Office of Inspector General and Office of General Counsel provided valuable insight in the training.

- In addition, the Office of Business Development is conducting on-going training in all aspects of the 8(a) Program for Business Development field staff in an effort to ensure compliance with governing 8(a) Program regulations.

- The Office of Business Development developed an online web-based tutorial linked to the 8(a) application package in an effort to ensure that potential applicants understand the requirements of the 8(a) Program. Prior to applying for the 8(a) Program, each firm is urged to take an on-line training and self-evaluation course which is accessible from SBA's web site.

- The Office of Field Operations, in collaboration with the Office of Business Development, and the Office of Human Capital Management, has convened a task force to review and assess the training needs for Business Development Specialists.

- A draft Plan for individualized business development assistance to 8(a) firms has been developed and will be placed in the agency's clearance process by the end of March 2009.

Lender Oversight

Prior OIG Audit Reports and other reviews identified substantial problems with the Agency's oversight of lenders. This raised considerable concerns about potential waste, fraud and abuse in the agency's loan programs. As a result of OIG reports and the Agency's concerns in this area, the Agency established the Office of Lender Oversight in 1999. It was reorganized in 2007 and renamed the Office of Credit Risk Management (OCRM).

The OCRM is charged with oversight of our lending partners and with the analysis of SBA's loan programs. This includes developing procedures to analyze and monitor the risk management profile of SBA's loan portfolio and its lenders.

The office conducts a continuous, risk based, off-site analysis of our lending partners through our Loan/Lender Monitoring System. Lending partners may access their risk and portfolio performance information through our Lender Portal. In addition, the office performs strategic on-site reviews of our lending partners' activities including the performance of their SBA lending operations and compliance with program rules and regulations. The Office of Credit Risk Management also assesses the quality of the overall SBA loan portfolio. Through this analysis it identifies and analyzes trends. As a result of this trend analysis and assessment of other analytical risk indicators, we are able to better understand lender and portfolio performance.

Oversight of our lending partners and analysis of SBA's loan programs are some of the Agency's most important functions. The activities of the Office of Credit Risk Management not only help protect the interest of the American taxpayer, but also enable our lending partners to better understand how best to fulfill the requirements of the lending programs in a way that is mutually beneficial.

One of the components of the on-site risk-based reviews is to review a sample of loans for compliance with lender and SBA policies, procedures, and documentation requirements. However, reviewers are also asked to note any instances of potentially suspicious activity at either the lender or loan level. Any instances of potentially suspicious activity are referred to OIG. Also, as part of the on-site review, reviewers question the lender about actions the lender is taking to prevent fraud. While the nature of the reviews is such that not all fraud may be detected (since only a sample of loans is reviewed and as fraud detection is more the expertise and purview of the OIG), the review process may be able to assist in detecting systemic fraud across a lender's portfolio. The on-site reviews are performed on lenders holding almost 85% of all guarantee dollars. Any material deficiencies that may affect the guarantee of any of the loans sampled during the review are noted in SBA's system. In the event that loan is subsequently purchased by SBA, the deficiencies are noted and reviewed to determine whether a guaranty repair or denial should occur.

Credit Elsewhere

Regarding our Credit Elsewhere Policy – This recently completed audit had only one recommendation – that SBA issue more detailed guidance to lenders to ensure documented lender compliance with credit elsewhere. SBA agreed with the recommendation. We were very pleased to see that GAO in its audit report recognized that OCRM's oversight efforts are making a difference, and that they are helping lenders to understand and comply with SBA's policies.

SBIC Program

An OIG audit report identified concerns that the SBIC liquidation program was not always performing liquidation in a prompt and effective manner. As a result, the SBIC program revised its SOPs and internal control system to include better metrics on liquidation. In response to this action, the OIG management challenge on this area last year reflected all yellow and green ratings.

The Financial Statement Audit

In January 2004, the financial statement auditor issued a disclaimer on SBA's FY 2003 financial statement, and subsequent audits identified material weaknesses with the financial statements for succeeding years. The OIG management challenge for FY 04 reflected substantial problems that needed to be corrected. The weaknesses with the financial statement raised serious concerns about waste and abuse in SBA programs. During the following four years, the Agency made substantial efforts to improve its financial reporting system and made such progress that the OIG actually eliminated the management challenge for financial reporting in its management challenge report for FY 08.

Madam Chairwoman, our management team recognizes that there is always a need for improvement in the way we conduct our business. As I have outlined for you, we are not only working diligently to implement recommendations contained in Government Accountability Office and Inspector General reports but we are also constantly testing, evaluating and revising our internal operating procedures in order to better serve small businesses and aspiring entrepreneurs throughout our country. The controls that we currently have in place as well as the establishment of new ones will, we believe, provide that level of accountability and transparency that Americans expect of their government and which all of us here in SBA are committed to achieving.

Chairwoman Velazquez and other distinguished Members of this Committee, thank you again for the opportunity to submit this written statement in connection with the Committee's hearing on waste, fraud, and abuse in Government programs. I am happy to answer any questions you may have.